SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1940

No. 586

NEW YORK, CHICAGO & ST. LOUIS RAILROAD COMPANY,

Appellant,

vs.

DOROTHEA T. FRANK.

APPEAL FROM THE SUPREME COURT OF THE STATE OF NEW YORK.

STATEMENT AS TO JURISDICTION.

WILLIAM J. DONOVAN,
Counsel for Appellant.

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STATEMENT AS TO JURISDICTION.

The appellant, in support of the jurisdiction of this Court to review the above entitled cause on appeal, respectfully represents:

Statutory Provision Sustaining Jurisdiction.

The Act of February 13, 1925, Chapter 229, Section 1, 43 Stat. 936, 937 (United States Code, Title 28, Section 344), provides that Section 237 of the Judicial Code is amended to read in part as follows:

> "(a) A final judgment or decree in any suit in the highest court of a State in which a decision in the suit

could be had, where is drawn in question the validity of a treaty or statute of the United States, and the decision is against its validity; or where is drawn, in question the validity of a statute of any State, on the ground of its being repugnant to the Constitution, treaties, or laws of the United States, and the decision is in favor of its validity, may be reviewed by the Supreme Court upon a writ of error. The writ shall have the same effect as if the judgment or decree had been rendered or passed in a court of the United States. The Supreme Court may reverse, modify, or affirm the judgment or decree of such State court, and may, in its discretion, award execution or remand the cause to the court from which it was removed by the writ."

Conflicting Statutes Involved.

Section 20a of the Interstate Commerce Act, as amended February 28, 1920, 41 Stat. 494, § 439 (U. S. C. Title 49, Sec. 20a), upon which appellant relied, reads in part as follows:

"SEC. 20a, (1) That as used in this section the term 'carrier' means a common carrier by railroad (except a street, suburban, or interurban electric railway which is not operated as a part of a general steam railroad system of transportation) which is subject to this Act, or any corporation organized for the purpose of engaging in transportation by railroad subject to this Act.

"(2). From and after one hundred and twenty days after this section takes effect it shall be unlawful for any carrier to issue any share of capital stock or any bond or other evidence of interest in or indebtedness of the carrier (hereinafter in this section collectively termed 'securities') or to assume any obligation or liability as lessor, lessee, guarantor, indorser, surety, or otherwise, in respect of the securities of any other person, natural or artificial, even though permitted by the authority creating the carrier corporation, unless and until, and then only to the extent that, upon application by the carrier, and after investigation by the Commission of the purposes and uses of the proposed issue and

the proceeds thereof, or of the proposed assumption of obligation or liability in respect of the securities of any other person, natural or artificial, the Commission by order authorizes such issue or assumption * * *

* * * * * * *

"(7) The jurisdiction conferred upon the Commission by this section shall be exclusive and plenary, and a carrier may issue securities and assume obligations or liabilities in accordance with the provisions of this section without securing approval other than as specified herein.

* * * * * * *

"(11) Any security issued or any obligation or liability assumed by a carrier, for which under the provisions of this section the authorization of the Commission is required, shall be void, if issued or assumed without such authorization therefor having first been obtained, or if issued or assumed contrary to any term or condition of such order of authorization as modified by any order supplemental thereto entered prior to such issuance or assumption; but no security issued or obligation or liability assumed in accordance with all the terms and conditions of such an order of authorization therefor as modified by any order supplemental thereto entered prior to such issuance or assumption, shall be rendered void because of failure to comply with any provision of this section relating to procedure and other matters preceding the entry of such order of authorization * * *."

Section 143 of the New York Railroad Law (Consolidated Laws of New York, Vol. 48, p. 158) upon which the plaintiff below relied reads as follows:

"The rights of all creditors of, and all liens upon the property of, either of such corporations, parties to such agreement and act, shall be preserved unimpaired, and the respective corporations shall be deemed to continue

in existence to preserve the same, and all debts and liabilities incurred by either of such corporations shall thenceforth attach to such new corporation, and be enforced against it and its property to the same extent as if incurred or contracted by it. No actions or proceedings in which either of such corporations is a party shall abate or be discontinued by such agreement and act of consolidation, but may be conducted to final judgment in the names of such corporations, or such new corporation may be, by order of the court, on motion substituted as a party."

The question presented is which statute governs this case. The courts below held the State statute governed (R. 301-305).

Date of Judgment and Date of Application for Appeal.

The judgment sought to be reviewed was entered on the 28th day of June, 1940, in the Appellate Term of the Supreme Court of the State of New York, First Department.

An order denying leave to appeal from the judgment to the Appellate Division of the Supreme Court of the State of New York, First Department, was entered in the said Appellate Division on the 9th day of October, 1940.

The application for appeal was presented on the 11th day of October, 1940.

Nature of the Case and Ruling of the Court.

This was a suit begun in the Municipal Court of the City of New York, to collect from appellant the face amount of five overdue interest coupons upon bonds of the Northern Ohio Railroad Company, allegedly guaranteed by the Lake Erie & Western Railway Company. The appellant was alleged in the complaint (R. 277-284) to have become liable upon the guaranty by assuming it in connection with

the consolidation of the Lake Erie & Western with four other railroad companies, which resulted in the formation of the appellant. In its answer to the complaint appellant set up that it had never been authorized, as provided in Section 20a of the Interstate Commerce Act, *supra*, to assume the obligation described in the complaint (R. 287-289). Thereupon each party filed a motion for summary judgment, supported by required affidavits (R. 43-51). Appellant's motion and required affidavits set forth as its sole ground that Section 143 of the New York Railroad Law, *supra*, relied upon by plaintiff below (R. 13 and 301), was inconsistent with Section 20a of the Interstate Commerce Act, *supra*, and also that the said State act was superseded by the said Federal statute (R. 50). The court, in a written opinion, rejected these contentions, and upheld the validity and application of the State statute by what appears to be an artificial narrowing the Federal statute beyond what would seem to be its proper and reasonable scope (R. 292, 301). The court held that the Federal statute had no application to security obligations imposed by State law. For that reason it sustained the motion of the plaintiff below for summary judgment, and denied that of appellant (R. 7 and 8). To review that action, an appeal was perfected to the Appellate Term of the Supreme Court, First Department (R. 3). No formal assignments of error are required in that Court, the appeal itself constituting the challenge to the correctness of the action of the trial court in denying appellant's motion for summary judgment, and granting that of plaintiff below (R. 3). The Appellate Court affirmed, without opinion, the judgment of the trial court. Thereupon a formal motion was filed for leave to appeal to the Appellate Division of the Supreme Court, First Department, but such motion was denied by the Appellate Term on August 12, 1940. A similar motion

was filed in the Appellate Division, and denied by that court on October 9, 1940.

The judgment to be reviewed, therefore, was entered in the highest court of the State of New York in which a review could be had.

The Question Presented is Substantial.

The question sought to be reviewed is substantial. There are numerous State statutes similar to Section 143 of the New York Railroad Law, purporting to impose upon consolidated railroad companies the obligations of their constituent companies. Most of these statutes were, like the New York law, adopted prior to the passage of the Transportation Act of 1920, of which Section 20a is a part. One of the purposes of that Act was to vest in the Interstate Commerce Commission the exclusive regulatory power to determine in the public interest what financial burdens should be assumed by interstate carriers and "to prevent a possible impairment of the financial ability of interstate carriers to discharge their interstate commerce duties." (*Railroad Commission* v. *Southern Pacific Co.*, 264 U. S. 331 (1924)). In furtherance of that purpose, Congress provided in Section 20a that interstate carriers should not assume any obligations in respect of the securities of others without the consent of the Interstate Commerce Commission, and that any purported assumption without such consent should be void. Section 143 of the New York Railroad Law and similar State statutes are in direct conflict with said Federal statute if they are applied, as the New York law has been by the State courts here, to security obligations of the constituents of a consolidated interstate carrier which has not received authority from the Interstate Commerce Commission to assume such obligations.

Certainly the financial ability of interstate carriers to discharge their interstate commerce duties may be hamp-

ered quite as much by security obligations attaching by operation of law as a result of consolidations as by security obligations expressly assumed. Congress, intending to give the Interstate Commerce Commission power to regulate the security obligations of carriers, can hardly have intended virtually to nullify that power as to consolidated carriers by permitting security obligations to be imposed upon such carriers by State statutes. The defendants' consolidation was accomplished under State laws, and the consent of the Commission to such consolidation was not required. (*Snyder* v. *New York Chicago & St. Louis Railroad Co.*, 278 U. S. 578 (1929)). If Section 20a is construed as it has been by the State courts, the Commission was, therefore, powerless at that time to prevent the defendant or other interstate carriers from undertaking heavy security obligations as the result of consolidation. Section 143 of the New York Railroad Law, applied as it has been by the New York courts, is invalid because in conflict with the words and policy of the Interstate Commerce Act. Under that Act, the Interstate Commerce Commission has exclusive jurisdiction to determine what security obligations shall be undertaken by interstate carriers, and the States have no power to impose such obligations without the approval of the Commission.

Concretely stated, the judgment here sought to be reviewed takes away the power which Congress conferred upon the Interstate Commerce Commission in Section 20a of the Interstate Commerce Act, and transfers that power to the State authorities. This Court should say whether the Federal statute may be evaded in the manner pointed out by the courts below.

The question is one which has not been previously decided by this Court. In *Mars* v. *Missouri-Kansas-Texas R. Co.*, 278 U. S. 258 (1929), the validity of a Texas statute

providing that in case of a sale of railroad property, the property should be "charged with and subject to" all subsisting liabilities for property damage was questioned as repugnant to Section 20a of the Interstate Commerce Act. This Court, in holding that the State statute was valid, did so solely on the ground that the obligations imposed by it were not obligations "in respect of securities". In the present case, the obligations sought to be imposed upon the defendant are, of course, security obligations. In no other reported case has the question of the validity of a State statute of this character, challenged as repugnant to Section 20a of the Interstate Commerce Act, been considered by this Court.

Although the conflict of statutes in the *Mars* case was apparently far less substantial than in the case at bar, this Court, nevertheless, took jurisdiction thereof by appeal rather than on certiorari.

Cases Believed to Sustain Jurisdiction.

The following decisions of this Court are believed to sustain jurisdiction of this appeal:

Mars v. *Missouri-Kansas-Texas R. Co.*, 278 U. S. 258 (1929);

Alabama Ry. v. *Jackson Ry.*, 271 U. S. 244 (1926);

Dahnke-Walker Co. v. *Bondurant*, 257 U. S. 282 (1921);

Ward & Gow v. *Krinsky*, 259 U. S. 503, 510 (1922);

Fiske v. *State of Kansas*, 274 U. S. 380, 385 (1927);

Bryant v. *Zimmerman*, 278 U. S. 63, 67.

Respectfully submitted,

WILLIAM J. DONOVAN,
Counsel for Appellant.

EXHIBIT "A".

(Opinion of Whalen, J.)

Supreme Court of the State of New York, Appellate Term. First Department.

DOROTHEA T. FRANK, Plaintiff-Respondent,

against

NEW YORK, CHICAGO & ST. LOUIS RAILROAD COMPANY, Defendant-Appellant

March 15, 1940.

Hon. Thomas J. Whalen, Justice.

House, Grossman, Vorhaus & Hemley, Esqs., 521 Fifth Avenue, New York, N. Y., Attorneys for the Plaintiff.

Donovan, Leisure, Newton & Lumbard, Esqs., 2 Wall Street, New York, N. Y., Attorneys for the Defendant.

WHALEN, *J.:*

Plaintiff moves for summary judgment in an action upon interest coupons attached to bonds issued by the Northern Ohio Railway Company under date of October 1, 1895, bearing the guaranty of punctual payment endorsed thereon by The Lake Erie & Western Railroad Company. There are five causes of action based upon five separate coupons, maturing April 1, 1939, in the sum of $25 each, and unpaid. The defendant is a consolidated corporation organized April 11, 1923, pursuant to the statutes of New York, Pennsylvania, Ohio, Indiana and Illinois, and is being sued as a New York corporation. The Lake Erie & Western Railroad Company was an Illinois corporation and was one of the constituents of the consolidated corporation.

Section 143 of the Railroad Law of the State of New York, pursuant to which the consolidation was effected, provides that the debts and liabilities of the several consolidating corporations shall attach to and become liabilities of the consolidated corporation. Hence this suit against this defendant.

Defendant interposes two defenses:

1) That the guaranty given by The Lake Erie & Western was ultra vires and wholly void.

2) That the defendant, an interstate carrier, was never authorized by the Interstate Commerce Commission to assume the guaranty as required by Section 20(a) of the Interstate Commerce Act, and that without that authorization there can be no liabiliy inasmuch as any such assumption of liability is illegal and void.

In its brief defendant does not question the sufficiency of the affidavits presented on plaintiff's affirmative case.

In support of its defense of ultra vires defendant presents voluminous affidavits and exhibits from the records of the corporations directly involved which, it is claimed, raise at least an issue of fact as to the power of The Lake Erie & Western to guarantee payment of the bonds and coupons of the Northern Ohio, and consequently require a denial of the motion.

Briefly summarized, defendant presents the following facts respecting the history and relationships of defendant, The Lake Erie & Western and the Northern Ohio:

The Lake Erie & Western was an Illinois corporation organized February 10, 1887.

The Pittsburgh, Akron & Western Railway Company was an Ohio corporation operating a line of railway in the State of Ohio. In 1894, having defaulted in payment of interest on its first mortgage bonds, a proceeding was brought to foreclose the mortgage and a decree of foreclosure was entered, May 23, 1894.

On October 8, 1894, at a directors' meeting of The Lake Erie & Western, the President, Calvin S. Brice, was authorized to acquire the railway if he could do so within certain limited terms. He thereafter conducted negotiations through a corporation controlled by him, called the Central Contract & Finance Co., with a Committee representing the bondholders on the defaulted bonds of the P. A. & W. leading to an agreement whereby The Lake Erie & Western, instead of purchasing the railway outright, arranged to organize a new corporation to which title would pass and then have The Lake Erie & Western lease the line of railway

perpetually and pay as rental the net proceeds of the line to the lessor and also to guarantee payment of principal and interest of bonds to be issued by the new corporation. This was later done except that the line was leased for 999 years instead of perpetually. A new corporation, the Northern Ohio Railway Co. was organized under the laws of the State of Illinois. The Northern Ohio issued bonds in the amount of $2,500,000, secured by a first mortgage on its line and The Lake Erie & Western arranged with a syndicate of bankers, headed by Vermilye & Co., to sell the bonds with the guaranty of The Lake Erie & Western endorsed thereon. From the records it appears that this guaranty was a very important, if not the principal, consideration for the purchase of the bonds.

A lease was given by the Northern Ohio to The Lake Erie & Western, of all its properties for 999 years. All these proceedings were approved and thereafter ratified by the Boards of Directors and stockholders of both corporations, the active agent at all times being Calvin S. Brice, the President of The Lake Erie & Western.

While all these various steps took time and were accomplished on various dates, the effective date of the whole operation including the bonds, mortgage and lease, was October 1, 1895. Thereafter, until 1919, the line of railway owned by the Northern Ohio was operated under the lease by The Lake Erie & Western.

As to the defense of ultra vires, defendant cites the general principle, to the effect that a corporation, unless authorized by its charter or the statutes of the state of its organization, is without authority to guarantee the bonds or debts of any other corporation. This rule is expressed in the following excerpt from *Louisville (etc.) Ry. Co.* v. *Louisville Trust Co.*, 174 U. S. 552 (1898):

"A railroad corporation unless authorized by its act of incorporation or by other statutes to do so, has no power to guarantee the bonds of another corporation; and such a guaranty, or any contract to give one, if not authorized by statute, is beyond the scope of the powers of the corporation, and strictly ultra vires, unlawful and void, and incapable of being made good by ratification or estoppel."

However, there are exceptions to this general rule and in the opinion in the same case, at page 573, appears the following:

"One who takes from a railroad or business corporation in good faith, and without actual notice of any inherent defect, a negotiable obligation issued by order of the board of directors, signed by the president and secretary, in the name and under the seal of the corporation and disclosing upon its face, no want of authority, has the right to assume its validity, if the corporation could, by any action of its officers or stockholders, or of both, have authorized the execution and issue of the obligation."

These bonds and their interest coupons, payable to bearer, are negotiable instruments.

Evertson v. *National Bank of Newport*, 66 N. Y. 15.

There is no reason shown here to doubt that plaintiff is a bona fide purchaser for value without notice of any defect in these bonds or coupons.

The Lake Erie & Western was an Illinois corporation organized in 1887. It was not expressly authorized either in its Articles of Incorporation or by any general statute of Illinois to guarantee the obligations of any other person, natural or artificial. The power, if it had any, to make the guaranty must be found in the implied powers of the corporation. A corporation has implied powers to do all things necessary or incidental to the exercise of the powers expressly granted.

Calument etc. Dock Co. v. *Conkling*, 273 Ill. 318-322.

Under the statutes of Illinois (Act of February 12, 1855; Laws 1855, p. 304) a railroad corporation of that State had power to enter into leases with other railroad corporations:

Pennsylvania R.R. Co. vs. *St. Louis, Alton & Terre Haute Railroad Company*, 118 U. S. 290 (1885).

It has been held that if a railroad corporation has power to take a lease of the lines of another corporation it has power to make agreements appropriate to such a transac-

tion, such as payment of rent and guaranteeing payment of bonds of the lessor.

6 Fletcher Cyc. Corp., Sec. 2719, p. 574.

Eastern Townships Bank vs. *St. Johnsbury & L. C. R. Co.*, 40 Fed. 423, writ of error dismissed 149 U. S. 772.

When a railroad corporation has possession of bonds of another railroad corporation it has power to endorse its guaranty thereon for the purpose of sale.

Railroad Co. vs. *Howard*, 7 Wall. 392 (1868);

Arnot vs. *Erie Railway Co.*, 67 N. Y. 315 (1876).

When the guarantor is in reality the principal and the ostensible obligor on the bonds is in reality the creature of the guarantor the guarantee will be valid.

Lake St. El. R.R. Co. vs. *Carmichael*, 184 Ill. 348 (1900).

It seems to me that this case comes within all of these exceptions to the general rule.

The guaranty was not executed for the accommodation of the Northern Ohio, but the entire transaction was a device engineered by The Lake Erie & Western for its own accommodation, in order to enable it to acquire control of the line of the old P. A. & W. so as to extend The Lake Erie & Western lines eastward.

Calvin S. Brice gave the instructions to a firm of attorneys for the organization of the Northern Ohio, for the preparation of the bond and mortgage and for the preparation of the lease. The Lake Erie & Western was the principal in the same way as the railroad was the principal in the Carmichael case.

Defendant claims The Lake Erie & Western never had actual possession of the bonds but they constructively passed through the hands of its secretary when he authorized delivery to Vermilye & Co., and in any event the question is not what was actually done but what The Lake Erie & Western had power to do so far as an innocent purchaser for value is concerned.

Louisville (etc.) Ry. Co. vs. *Louisville Trust Co.* (supra).

The information about this was not a matter of public record and defendant would be estopped from setting up any mere irregularity as against this defendant. (*Idem.* p. 575.)

The Lake Erie & Western had express power under the Illinois statute to enter into a lease arrangement with another railroad and it had implied power to make such terms as were necessary to carry out the lease.

In the case of Eastern Townships Bank vs. St. Johnsbury & L. C. R. Co. (supra) it was held that a lessee railroad corporation had power to guarantee payment of the bonds of its lessor, in view of a state statute authorizing one railroad corporation to lease the lines of another. The Vermont statute (R. L. Vt. Sec. 3303) is similar to the Illinois statute (L. 1855, p. 304, R. S. 1874, p. 807).

The cases of ultra vires cited by defendant are all cases where the transactions were held to be ultra vires because they were not made in furtherance of the purposes for which the corporations were organized, or because they were made in direct violation of a statute, such as the statutes of Illinois relating to the acquisition of land by a corporation. No Illinois statute has been cited prohibiting a railroad corporation from guaranteeing bonds in any case and under any circumstances. Defendant has cited no case which pushes the doctrine of ultra vires to the extent urged in this case.

In support of its second defense, defendant cites Section 20 (a) of the Interstate Commerce Act, and submits affidavits showing that no application was ever made to, or authorization ever granted by, the Interstate Commerce Commission to the assumption by defendant of liability on the guaranty in question.

Defendant urges this as a conclusive bar to the action and because the facts are not disputed makes a cross motion for summary judgment in its favor.

Section 143 of the Railroad Law of the State of New York provides that in case of consolidation "all debts and liabilities incurred by either of such corporations shall thenceforth attach to such new corporation."

Section 20 (a) of the Interstate Commerce Act, as amended by the Transportation Act of 1920, provides that it shall be unlawful for any carrier to issue or assume any

liability in respect of the securities of any other person, natural or artificial, unless the Interstate Commerce Commission authorizes such assumption.

Defendant claims that Section 20 (a) supersedes Section 143 of the New York Railroad Law and, inasmuch as no authorization has been obtained, the consequence is defendant has assumed no liability as guarantor of the Northern Ohio bonds.

Again defendant cites no cases directly in point. It claims that

> *Missouri-Kansas Texas R. Co. of Texas* v. *Mars*, 294 S. W. 941 (Texas Civil Appeals 1927)

is in point, but that case was reversed by the Texas Commission of Appeals (298 S. W. 271, 1927), and the reversal was affirmed by the United States Supreme Court (278 U. S. 258) on the ground that securities were not involved in the case.

It seems to me that the dispute here revolves around the meaning to be given to the word "assume" as used in Section 20 (a) of the Interstate Commerce Act. If that means something different than the liability imposed by Section 143 of the Railroad Law of the State of New York, the two statutes may be reconciled and there is no conflict between them. If they do have the same meaning, then undoubtedly the Commerce Act controls because it is the supreme law of the land.

The word "assume" connotes a voluntary action and is directly applicable to leases where a lessee railroad attempts to assume liability on the debt of its lessor. This happened in

> *New York Central Securities Corp.* v. *U. S.*, 54 Fed. (2d) 122, S. D. N. Y., 1931, aff'd 287 U. S. 12 (1932).

Words & Phrases, Fifth Series, Vol. 1, p. 592, defines the word "assume" as "to take upon oneself."

The word "assume" does not appear in Section 143 of the Railroad Law. Defendant argues as though it does. Instead the word "attach" appears. At the moment of consolidation the defendant did not "assume" the debts of The Lake Erie & Western. Instead, these debts immediately

became its own debts. It acquired a direct liability of its own. It did not at that moment guarantee any debt of The Lake Erie and Western, but, rather, became liable on its own debt which attached by reason of the statute. It did not assume an "obligation" of any other person, natural or artificial.

No instance has been cited to me of any application to the Interstate Commerce Commission by a consolidated corporation to assume the debts of the constituent corporations, and I think the reason may be found in the fact that the Interstate Commerce Commission has not yet assumed jurisdiction over the subject of consolidation under Section 5 of the Interstate Commerce Act, but has left these proceedings entirely to the jurisdiction of the States.

Snyder v. *New York, Chicago & St. Louis R. Co.*, 278 U. S. 578;

Operation of Lines and Issue of Capital Stock by the New York, Chicago & St. Louis Railroad Company, 71 I. C. C. 581.

Therefore, no approval was sought of the Commission for the consolidation and none was necessary.

The Commission did, however, issue a certificate of convenience and necessity and must have done so with knowledge of the incidents of the consolidation under State law, including the attaching of the liabilities of the constituent corporations to the consolidating corporation.

The complaint, it seems to me, falls into the same error in the use of the word "assume" in the fifth paragraph. However, as that is a conclusion of law, it may be disregarded as surplusage, inasmuch as the other allegations of the paragraph (if we accept the word "merger" as meaning "consolidation") state the essential facts for a cause of action.

My conclusion is that it was not necessary for the defendant to make an application to the Interstate Commerce Commission or to receive its authorization under Section 20 (a) before becoming liable on The Lake Erie & Western guaranty of the Northern Ohio bonds.

It follows that defendant's motion for summary judgment must be denied, and plaintiff's motion will be granted.